

## Internal Revenue Service, Treasury

## § 1.281-3

	Before the appli- cation of sec. 281	After the applica- tion of sec. 281
Expenses for accrued charges for re- lated terminal services performed by TR Co .....	30,000	27,000
	105,550	100,000
Taxable income .....	47,450	50,000

[T.D. 7356, 40 FR 23733, June 2, 1975]

### § 1.281-3 Definitions.

(a) *Terminal railroad corporation.* The term *terminal railroad corporation* means a corporation which, in the taxable year, meets all of the following conditions:

(1) The corporation and each of its shareholders must be domestic corporations. Thus, all of the shareholders of the corporation, as well as the corporation itself, must be corporations which were organized or created in the United States, including only the States and the District of Columbia, or under the law of the United States or of any State or territory.

(2) All of the shareholders must be railroad corporations which are subject to Part I of the Interstate Commerce Act. Thus, if any shareholder of the corporation, regardless of the class or percentage of stock owned, is not subject to the jurisdiction of the Interstate Commerce Commission under part I of that Act, the corporation cannot qualify as a terminal railroad corporation.

(3) The corporation must not be a member of an affiliated group of corporations (as defined in section 1504), other than as a common parent corporation. For this purpose it is immaterial whether or not the affiliated group has ever made a consolidated income tax return. Thus, if the X railroad corporation owns 80 percent of all of the outstanding stock of the Y railroad corporation, the X railroad corporation may qualify, but the Y railroad corporation cannot qualify, as a terminal railroad corporation.

(4) The primary business of the corporation must be that of providing to domestic railroad corporations subject to Part I of the Interstate Commerce Act and to the shippers and passengers of such railroad corporations one or

more of the following facilities or services: (i) Railroad terminal facilities, (ii) railroad switching facilities, (iii) railroad terminal services, or (iv) railroad switching services. The designated facilities and services include the furnishing of terminal trackage, the operation of stockyards or a union passenger or freight station, and the operation of railroad bridges and ferries. The providing of the designated facilities includes the leasing of those facilities. A corporation shall be considered as having established that its primary business is that of providing the designated facilities and services if more than 50 percent of its gross income (computed without regard to section 281, and excluding dividends and gains and losses from the disposition of capital assets or property described in section 1231(b)) for the taxable year is derived from those sources. The fact that income from a service or facility is included within the definition of related terminal income is immaterial for purposes of determining whether that service or facility is one which is designated in this subparagraph. Thus, although income from the operation of a commuter railroad line may be related terminal income, a corporation whose primary business is the operation of that facility is not a terminal railroad corporation, since its primary business is not the providing of the designated facilities or services.

(5) A substantial part of the services rendered by the corporation for the taxable year must be rendered to one or more of its shareholders. For purposes of this requirement, providing the use of facilities shall be considered the rendering of services.

(6) Each shareholder of the corporation must compute its taxable income on the basis of a taxable year which either begins or ends on the same day as the taxable year of the corporation.

(b) *Related terminal income.*—(1) *In general.* Related terminal income is, generally, the type of income normally earned from the operation of a railroad terminal. The term *related terminal income* means the taxable income (computed without regard to sections 172, 277, or 281) which the terminal railroad corporation derives for the taxable year from the sources enumerated in

paragraph (b)(2) of this section. Related terminal income must be derived from direct provision of the specified facilities or services by the terminal corporation itself. Thus, income consisting of rent from a lease of a terminal facility by a terminal corporation to a railroad user would qualify; but dividends from a corporation in which the terminal corporation owned stock and which provided such facilities or services to others would not qualify. The term does not include gain or loss derived from the sale, exchange, or other disposition of capital assets or section 1231 assets, whether or not section 1245 or section 1250 applies to part or all of that gain. For example, the term does not apply to gain from the sale of a terminal building or terminal equipment. All direct and indirect expenses and other deductible items attributable to related terminal services or facilities shall be deducted in determining related terminal income. Attribution shall be determined in accordance with customary railroad accounting practices accepted by the Interstate Commerce Commission, except that interest paid with respect to the indebtedness of a terminal railroad corporation shall be deducted from related terminal income to the extent that the proceeds from the indebtedness were directly or indirectly applied to facilities or activities producing such income. The district director may either accept the use of the taxpayer's method of determining the application of the proceeds of all indebtedness of such corporation or prescribe the use of another method which, under all the facts and circumstances, appears to reflect more accurately the probable application of such proceeds.

(2) *Sources of related terminal income.* The term *related terminal income* includes only income derived from one or more of the following sources:

(i) From services or facilities of a character ordinarily and regularly provided by terminal railroad corporations for railroad corporations or for the employees, passengers, or shippers of railroad corporations. Whether the services or facilities are of a character ordinarily and regularly provided by terminal railroad corporations is to be determined by accepted industry prac-

tice. The fact that nonterminal businesses may also provide such services or facilities is immaterial. However, there must be a direct relationship between the service or facility provided and the operation of the terminal, including the operation of its trackage and switching facilities. Thus, the term *related terminal income* includes income derived from operating or leasing switching facilities and terminal facilities, such as income from charges to railroad corporations for the use of a union passenger or freight station. Also included for this purpose is income derived from charges to railroad shippers, including express companies and freight forwarders, for the use of sheds or warehouses, even though not directly intended for railroad use. The term includes income derived from leasing or operating restaurants, drugstores, barbershops, newsstands, ticket agencies, banking facilities, car rental facilities, or other similar facilities for passengers, in waiting rooms or along passenger concourses. Similarly, the term includes income derived from operating or leasing passenger parking facilities, and from renting taxicab space, located on or adjacent to the terminal premises. Although the term does include income derived from the operation of a small hotel operated primarily for and usually occupied primarily by the employees of the railroad corporations, it does not include income derived from the operation of a hotel for passengers or other persons.

(ii) From any railroad corporation for services or facilities provided by the terminal railroad corporation in connection with railroad operations. A service or a facility is provided in connection with railroad operations if it is of a character ordinarily and regularly availed of by railroad corporations. For purposes of this subdivision, the income must be derived from railroad corporations. Thus, in addition to the income derived from sources described in paragraph (b)(2)(i) of this section, the term *related terminal income* includes income derived from switching facilities or leasing to any railroad corporation, or operating for the benefit of such corporation, a beltline or bypass

railroad leading to or from the terminal premises. Also included are income derived from the rental of office space (whether or not services are provided to the occupants) in the terminal building to any railroad corporation for that corporation's administrative or operating divisions, and income derived from tolls charged to any railroad corporation for the use of a railroad bridge or ferry.

(iii) From the use by persons other than railroad corporations of a portion of a facility, or of a service, which is used primarily for railroad purposes. A facility or service is used primarily for railroad purposes if the predominant reason for its continued operation or provision is the furnishing of facilities or services described in either subdivision (i) or (ii) of this subparagraph. The determination required by this subdivision is to be made independently for each separate facility or service. Two substantial portions of a single structure may be considered separate facilities, depending upon the respective uses made of each. Moreover, any substantial addition, constructed after October 23, 1962, to a facility shall be considered a separate facility.

The term *related terminal income* includes income produced by operating a commuter service or by renting tracks and facilities for a commuter service to an independent operator. The term also includes the sale or rental of advertising space at a terminal facility. If the conditions described in this subdivision are satisfied, the term *related terminal income* may include income which has no connection with the operation of the terminal. Thus, if a terminal railroad corporation operates a railroad bridge primarily to provide railroad corporations a means of crossing a river and the lower level of the bridge contains a roadway for similar use by automobiles, the term includes income derived from the tolls charged to the automobiles for the use of the bridge roadway. However, upon the discontinuance of operations of the railroad level of the bridge, the term would cease to include the automobile tolls. If excess steam from a steam plant operated primarily to supply steam to the terminal is sold to another business in the neighborhood, the term

would include the income derived from such sale. However, because an oil or gas well or a mine constitutes a separate facility, the term *related terminal income* does not include income derived in any form from a deposit of oil, natural gas, or any other mineral located on property owned or leased by the terminal railroad corporation.

Similarly, while the term includes income derived from the rental of a small number of offices located in the terminal building (whether or not the lessees are railroad corporations), it does not include income derived from the leasing or operation, for the use of the general public, of a large number of offices or a large number of rooms for lodging, whether or not the space is physically part of the same structure as the terminal. Moreover, the term does not include income derived from the rental of offices to the general public in an addition to the terminal building constructed after October 23, 1962, unless the addition is primarily used for railroad purposes and the offices rented to the general public do not constitute a separate facility in the addition. Whether or not income from the addition is determined to be related terminal income, the income from the small number of offices which were included in the terminal building before the addition was constructed shall continue to be related terminal income.

(iv) From the United States in payment for facilities or services in connection with mail handling. The income must be derived directly from the U.S. Government, or any agency thereof (including for this purpose the U.S. Postal Service), through the receipt of payments for mail-handling facilities or services. Thus, the term would include income derived from the rental of space for a post office for use by the general public on the terminal premises or from the sorting of mail in a railroad box car.

(3) *Illustration.* The provisions of this paragraph may be illustrated by the following example:

*Example.* For its calendar year 1973, the R Company, a terminal railroad corporation, has taxable income of \$36,000, before the application of section 281 and taking no account of section 277, determined as follows:

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Gross income:		Other hotel expenses .....	3,000
Switching charges .....	\$50,000		
Express companies .....	2,000		4,500
Commuter line .....	4,000		
U.S. mail handling .....	4,000		9,500
Railroad bridge tolls:			
From railroads .....	2,000		17,000
From automobiles .....	1,000		
			19,000
Total .....	3,000	Add:	
Station and train charges .....	47,000	Loss from sale of securities .....	3,000
Terminal parking lot .....	4,000	Charitable contribution .....	500
Rent from terminal building:		Net operating loss deduction .....	1,500
Passenger facilities (ground level) .....	8,000		5,000
Offices leased to railroads (2d floor) .....	3,000		
Offices leased to others (2d floor) .....	1,000	Related terminal income .....	24,000
Hotel open to public (3d through 6th floors) .....	14,000		
Total .....	26,000		
Interest received from bond investments .....	1,500		
Dividends received from wholly owned subsidiary .....	10,000		
Amount realized from sale of equipment .....	6,000		
Less:			
Adjusted basis .....	1,000		
Expenses of sale .....	500		
	1,500		
	4,500		
	156,000		
Allowable deductions:			
Dividend received deduction .....	8,500		
Interest paid:			
On loan for hotel furnishings .....	1,500		
On loan for rolling stock .....	2,000		
	3,500		
Maintenance, depreciation, management and other expenses:			
Attributable to hotel .....	3,000	Switching charges .....	\$50,000
Attributable to parking lot .....	1,000	Express companies .....	2,000
Attributable to U.S. mail handling .....	1,000	Commuter line .....	4,000
All other .....	98,000	U.S. mail handling .....	4,000
	103,000	Railroad bridge tolls .....	3,000
Loss from sale of securities .....	3,000	Station and train charges .....	47,000
Charitable contribution .....	500	Terminal parking lot .....	4,000
Net operating loss deduction .....	1,500	Rent from:	
	120,000	Passenger facilities .....	8,000
		Offices .....	4,000
		Total .....	126,000
Taxable income before the application of sec. 281 .....	36,000		
The R Co.'s related terminal income for 1973 is \$24,000, computed as follows:			
Taxable income (before the application of sec. 281) .....	36,000		
Less:			
Dividend received .....	10,000		
Minus dividend received deduction .....	8,500		
	1,500		
Interest received .....	1,500		
Amount realized from sale of equipment .....	6,000		
Less:			
Adjusted basis .....	1,000		
Expense of sale .....	500		
	1,500		
	4,500		
Hotel income .....	14,000		
Less:			
Interest paid on loan for hotel .....	1,500		

(c) *Related terminal services.* The term *related terminal services* means only the services or the use of facilities, provided by the terminal railroad corporation, which are taken into account in computing related terminal income. Thus, the term includes the providing of terminal and switching services, the furnishing of terminal and switching facilities including the furnishing of terminal trackage, and the operation of bridges and ferries for railroad purposes. For example, upon the facts of the example in the preceding paragraph, the charges for related terminal services are \$126,000, determined as follows:

Switching charges .....	\$50,000
Express companies .....	2,000
Commuter line .....	4,000
U.S. mail handling .....	4,000
Railroad bridge tolls .....	3,000
Station and train charges .....	47,000
Terminal parking lot .....	4,000
Rent from:	
Passenger facilities .....	8,000
Offices .....	4,000
Total .....	126,000

(d) *Agreement.* As used in section 281 and §1.281-2 the term *agreement* means a written contract, entered into before the beginning of the terminal railroad corporation's taxable year in question, to which all shareholders of the terminal railroad corporation are parties. The fact that other railroad corporations or persons are also parties will not disqualify an agreement. Section 281 applies only if, and to the extent that, the reduction of the liability or charge that would be made, as described in paragraph (c) of §1.281-2, results from the agreement. Thus, where the other conditions of the statute are met, section 281 applies if a written

agreement, to which all of the shareholders were parties and which was entered into prior to the beginning of the terminal railroad corporation's taxable year, provides that the net revenues of the terminal railroad corporation are to be applied as a reduction of what would otherwise be the charge for the taxable year for related terminal services provided to the shareholders. Similarly, section 281 applies, where its other requirements are fulfilled, if the agreement provides that the net revenues are to be credited against rental obligations resulting from related terminal services furnished to shareholders. However, section 281 does not apply where the agreement provides that the net revenues are to be divided among the shareholders and distributed to them in cash or held subject to their unconditional right of withdrawal instead of being applied to the computation of charges, or in reduction of liabilities incurred, for related terminal services.

(e) *Railroad corporation.* For purposes of section 281, § 1.281-2, and this section, the term *railroad corporation* means any corporation (regardless of whether it is a shareholder of the terminal railroad corporation) that is engaged as a common carrier in the furnishing or sale of transportation by railroad, or is a lessor of railroad equipment or facilities. For purposes of the preceding sentence, a corporation is a lessor of railroad equipment or facilities only if (1) it is subject to part I of the Interstate Commerce Act, (2) substantially all of its railroad properties have been leased to a railroad corporation or corporations, (3) each lease is for a term of more than 20 years, and (4) 80 percent or more of its gross income for the taxable year is derived for such leases.

[T.D. 7356, 40 FR 23735, June 2, 1975]

#### § 1.281-4 Taxable years affected.

(a) *In general.* Except as provided in paragraph (b) of this section, the provisions of section 281 and §§ 1.281-2 and 1.281-3 shall apply to all taxable years to which either the Internal Revenue Code of 1954 or the Internal Revenue Code of 1939 apply.

(b) *Taxable years ending before October 23, 1962.* (1)(i) In the case of a taxable year of a terminal railroad corporation

ending before October 23, 1962, section 281 (a) shall apply only to the extent that the terminal railroad corporation (a) computed its taxable income on its return for such taxable year as if the "reduced amount", described in paragraph (c) of § 1.281-2, were not received or accrued, and (b) did not decrease its otherwise allowable deductions for such taxable year on account of that "reduced amount". Similarly, in the case of a taxable year of a shareholder of a terminal railroad corporation ending before October 23, 1962, section 281(b) shall apply only to the extent that such shareholder computed its taxable income on its return for such taxable year as if the shareholder had neither received or accrued a dividend nor paid or incurred as an expense the "reduced amount" described in paragraph (c) of § 1.281-2. Such return must have been filed on or before the due date (including the period of any extension of time) for filing the return for the applicable taxable year. The fact that an amended return or claim for refund or credit of overpayment was subsequently filed, or a deficiency subsequently assessed, based upon a computation of taxable income which is inconsistent with the manner in which the taxable income was computed on the timely filed return, is immaterial.

(ii) The provisions of this paragraph may be illustrated by the following examples:

*Example 1.* The G Company is a terminal railroad corporation which in 1960 reduced the liabilities resulting from charges to its shareholders, pursuant to a 1947 written agreement, by its income from nonshareholder sources. For the calendar year 1960, the G Company's related terminal income was \$24,000, of which \$3,000 is attributable to income from the United States in payment for facilities and services in connection with mail handling. Although the shareholders' liabilities were reduced by \$24,000 as a result of taking related terminal income earned during the taxable year into account, on its timely filed 1960 income tax return the G Company treated the \$3,000 of liabilities which were reduced on account of income from mail handling as gross income received or accrued during the year. Assuming that the provisions of § 1.281-2 otherwise apply, their application to the determination of the 1960 tax liability of the G Company shall not extend to the entire "reduced amount" of